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Michael J. Shortley, III
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RochesterTel

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

BY OVERNIGHT MAIL

Donna R. Searcy
Secretary
Federal Communications Commission
1919 M Street, N. W.
Washington, D. C. 20554

Re: CC Docket No. 92-101

Dear Ms. Searcy:

Enclosed for filing please find an original plus seven (7) copies of the Direct Case of Rochester Telephone Corporation in this proceeding.

To acknowledge receipt, please affix an appropriate notation to the copy of this letter provided herewith for that purpose and return same to the undersigned in the enclosed self-addressed envelope.

Very truly yours,

Michael J. Shortley, III

Michael J. Shortley, III

[redacted]

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In the Matter of Treatment of Local Exchange Carrier Tariffs Implementing Statement of Financial Accounting Standards, "Employer's Accounting for Postretirement Benefits Other than Pensions"	CC Docket No. 92-101

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

DIRECT CASE OF
ROCHESTER TELEPHONE CORPORATION

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May 29, 1992

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Before the
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In the Matter of Treatment of Local Exchange Carrier Tariffs Implementing Statement of Financial Accounting Standards, "Employer's Accounting for Postretirement Benefits Other than Pensions"	CC Docket No. 92-101

DIRECT CASE OF
ROCHESTER TELEPHONE CORPORATION

Introduction and Statement of Facts

1. Summary

Rochester Telephone Corporation, on its behalf, that of its exchange carrier subsidiaries that concur in its Tariff F.C.C. No. 1[1/] and that of Vista Telephone Company of Iowa and Vista Telephone Company of Minnesota (together, the "Vista Telephone Companies" or "Vista"), all of which are collectively referred to hereafter as "Rochester," hereby submits its Direct

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1/ AuSable Valley Telephone Company, Inc., Breezewood Telephone Company, C, C & S Telco, Inc., Canton Telephone Company, Enterprise Telephone Company, Highland Telephone Company, Inland Telephone Company, Lakeshore Telephone Company, Lakeside Telephone Company, Lakewood Telephone Company, Midland Telephone Company, Midway Telephone Company, Mondovi Telephone Company, Monroeville Telephone Company, Inc., Mt. Pulaski Telephone & Electric Company, Ontonagon County Telephone Company, Orion Telephone Exchange Association, Oswayo River Telephone Company, Prairie Telephone Company, S & A Telephone Company, Inc., The Schuyler Telephone Company, Seneca-Gorham Telephone Corporation, Southland Telephone Company, Sylvan Lake Telephone Company, Inc., The Thorntown Telephone Company, Inc. and Urban Telephone Corporation.

Case in response to the Bureau's Order in this proceeding.[2/] In the Designation Order, the Bureau has named all price cap carriers as parties to the proceeding and has requested they demonstrate that the increase in current period expenses caused by the implementation of Statement of Financial Accounting Standard 106 ("SFAS 106") qualifies for exogenous treatment under price cap regulation.[3/] The Bureau has further designated for investigation the following issues:

> Are the assumptions made by the individual LECs in calculating these costs reasonable?
>
> Given these assumptions, have the individual LECs correctly computed the exogenous cost changes?
>
> Are the individual LEC allocations of those costs among the price cap baskets consistent with Commission rules?[4/]

SFAS 106 requires companies, effective for fiscal years

2/ Treatment of Local Exchange Carrier Tariffs Implementing Statement of Financial Accounting Standards, "Employer's Accounting for Postretirement Benefits Other than Pensions," CC Dkt. 92-101, Order of Investigation and Suspension, DA 92-540 (Com. Car. Bur. April 30, 1992) ("Designation Order").

3/ Id., ¶ 10 (Issue I).

4/ Id. (Issues II(b), (c) & (d)).

The Bureau has also requested the parties to address whether expenses incurred in implementing SFAS 106 prior to its mandatory implementation date should be accorded exogenous treatment. Id. (Issue II(a)). Because Rochester will not implement SFAS 106 until it becomes mandatory, Rochester takes no position on this issue.

beginning after December 15, 1992, to account for Other Post-Employment Benefits ("OPEBs") on an accrual, rather than on a cash (or pay-as-you-go), basis. The Commission has authorized all subject exchange carriers to adopt SFAS 106 accounting beginning on or before January 1, 1993.[5/]

The adoption of SFAS 106 will have a significant effect on the balance sheets and income statements of affected companies. This effect will consist principally of two components. First, SFAS 106 requires earlier recognition of expenses associated with OPEBs than is required under the current pay-as-you-go method of accounting. This is because SFAS 106 requires employers to accrue the costs of providing OPEBs during the years that the employees render the necessary service to earn those benefits. Second, the adoption of SFAS 106 has resulted in the creation of a transitional benefit obligation ("TBO"), which is defined as the unrecognized amount, as of the date that SFAS 106 is initially adopted, of the accumulated postretirement benefit obligation in excess of the fair value of plan assets plus any recognized accrued postretirement benefit cost or less any recognized prepaid benefit cost. SFAS 106 permits a company to recognize the TBO

5/ Southwestern Bell, GTE Corporation: Notification of Intent To Adopt Statement of Financial Accounting Standards No. 106, Employer's Accounting for Postretirement Benefits Other than Pensions, AAD 91-80, Order (Dec. 26, 1991).

either immediately in net income in the period of the change or on a delayed basis as a component of net periodic postretirement benefit cost. If delayed recognition is elected, the employer must amortize the TBO on a straight-line basis over the remaining service period of active plan participants, except that, if the average remaining service period is less than twenty years, the employer may elect a twenty year period.[6/]

In this Direct Case, Rochester will demonstrate that, under the Commission's price cap rules, this increased expense qualifies for exogenous cost treatment. As set forth in more detail below, mandatory accounting changes are one category of externally-imposed changes that qualify under the Commission's rules for exogenous cost treatment.

Historically, the rates charged by exchange carriers for regulated services have been restricted to recovering only those costs which the regulators have recognized as accounting costs for financial reporting purposes. Prior to SFAS 106, the accepted accounting practice upon which rates have been based was to recognize OPEB expenses when benefits were actually

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6/ The figures used in this Direct Case assume a twenty year amortization of the TBO. However, the average remaining service period of Rochester's active plan participants is approximately 16-18 years. When Rochester files its tariff revisions to reflect the implementation of SFAS 106, it may elect to utilize this shorter amortization period.

paid, rather than when the liability was incurred. The Commission has now required all subject exchange carriers to adopt the accounting treatment promulgated in SFAS 106. That requirement will result in an increased current period expense that exchange carriers must recognize on their books. Indeed, the price cap treatment of this accounting change is, in principle, no different from similar changes that the Commission has previously _required_ carriers to reflect through exogenous cost adjustments, _e.g._, the expiration of reserve deficiency amortizations.

Moreover, because this accounting change will, at most, have only a minuscule effect on GNP-PI, virtually all of this expense increase qualifies for exogenous cost treatment under the Commission's price cap rules. The two studies that have been submitted, one by the National Economic Research Associates ("NERA")[7/] and one by Godwins,[8/] show that, at most, the implementation of SFAS 106 will increase GNP-PI by only approximately 0.12%. An increase in GNP-PI of this

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7/ National Economic Research Associates, Inc., _The Treatment of FAS 106 Accounting Changes Under Price Cap Regulation_ (April 15, 1992), Pacific Bell, Tariff F.C.C. No. 128, Trans. 1579, Description & Justification, Section VI (April 16, 1992) ("NERA Study").

8/ Godwins, _Analysis of Impact of FAS 106 Costs on GNP-PI_, Bell Atlantic, Tariff F.C.C. No. 1, Trans. 497, Description & Justification, Attachment A (Feb. 28, 1992) ("Godwins Study").

magnitude would enable Rochester Telephone and Vista to recover only 4.2% and 6.4%, respectively, of the mandatory incremental increase in their OPEB expenses allocable to interstate access services. Therefore, the Commission should permit Rochester Telephone and Vista to recover the remainder of their incremental 1993 OPEB expenses through exogenous adjustments to their price cap indices. Rochester and Vista estimate that their exogenous cost adjustments will amount to $2,352,200 and $344,700, respectively. After the implementation of this one-time adjustment to the price cap indices, no further adjustments will be required to recognize the effects of SFAS 106, with the exception of a negative exogenous adjustment when the TBO becomes fully amortized.

Second, Rochester has correctly forecast the incremental costs that it will incur to implement SFAS 106 and has based those projections on reasonable actuarial assumptions.

Third, Rochester intends to allocate this expense increase among its price cap baskets in accordance with the "Big Three" expense allocators described in section 69.2(f) of the Commission's rules. The vast majority of Rochester's wage expense is reflected in these three factors and its OPEB expenses are wage related. Therefore, this methodology complies with the requirement that costs be allocated among the price cap baskets in a cost-causative manner.

2. A Description of Rochester's Postretirement Benefit Plans

Rochester Telephone (in this section, the local exchange carrier operating in the Rochester, New York, metropolitan area) and its subsidiary companies provide some combination of five types of postretirement benefits: life insurance; health care insurance; Medicare Part B reimbursement; medical reimbursement; and discounted telephone service. Exhibit I shows which of these benefits are offered by each company.

Based upon the benefit plans offered by Rochester Telephone, the following is a general description of each category of benefits.[9/]

Life Insurance -- Active employees are provided term life insurance in an amount equal to their annual salaries. Upon retirement, this level is fixed at the departure salary rate until the retiree's 66th birthday, at which time that amount is reduced 10% per year until the retiree's 70th birthday.

Health Insurance -- Rochester Telephone currently pays the full cost of single or family coverage for the Blue Cross/Blue Shield traditional plan. This plan provides full coverage of reasonable and customary charges associated with 120 days of hospitalization, surgery and emergency room care. Upon reaching age 65, Rochester Telephone pays for a Blue Cross/Blue Shield Medicare Complimentary plan that, in

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9/ Although there is some variation among the benefit plans offered by Rochester's subsidiaries, these descriptions are generally representative of the benefits offered by Rochester's subsidiaries as well.

conjunction with Medicare as the primary insurer, provides total coverage that is identical to the pre-65 plan.

In addition, Rochester Telephone provides coverage for services such as physicians' charges, out-patient billing, therapy and prescription drugs that are not covered under the basic plan. Retirees are required to meet an annual deductible of 1% of their pension up to a $100 maximum for each person covered and to pay 20% of any charges in excess of the deductible.

Medicare Part B -- Amounts deducted from Social Security checks for this health care benefit are reimbursable.

Medical Reimbursement -- Retirees may be reimbursed up to $125 per calendar year for out-of-pocket medical expenses.

Discounted Telephone Service -- Retirees with at least 20 years of active service receive 100% discounted local telephone service and a $35 monthly toll allowance for calls within Rochester Telephone's service territory. Retirees with less than 20 years service receive a 50% credit on their local telephone service. If the retiree resides within Rochester Telephone's territory, the discount is considered foregone revenue. Those retirees that reside outside Rochester Telephone's territory submit bills for reimbursement. Rochester has included in its OPEB revenue requirement accruals only for cash reimbursements to retirees who reside outside Rochester Telephone's territory.

3. Rochester's Accounting for Postretirement Benefits

In this section of its Direct Case, Rochester describes the manner in which it has accounted for and intends to account for OPEBs.[10/] The financial information contained in this description will be at a tariff entity level, *i.e.*, one for Rochester Telephone and the companies that concur in its Tariff F.C.C. No. 1 (referred to hereafter together as "Rochester Telephone") and one for Vista.

Rochester intends to implement SFAS 106 on January 1, 1993 and will follow the uniform accounting guidelines outlined in Responsible Accounting Officers Letter 20. Prior to that date, Rochester will continue to account for OPEBs on a pay-as-you-go basis.[11/] As shown on Exhibit III, page 1, 1991 and 1992 interstate regulated pay-as-you-go OPEB expenses for Rochester Telephone were $451,000 and $636,000 and for Vista were $87,000 and $142,000.

Because Rochester Telephone and Vista will continue to account for OPEB expenses prior to January 1, 1993 on a pay-as-you-go basis, none of the *incremental* OPEB expense that will result from implementing SFAS 106 is reflected in Rochester Telephone's or Vista's current rates or in their

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10/ *See* Designation Order, ¶¶ 11, 13.

11/ In reports filed with the Securities and Exchange Commission, Rochester has stated that it currently accounts for OPEBs on a pay-as-you-go basis. 1991 Annual Report at 42, attached as Exhibit II. *See* Designation Order, ¶ 11 (information request 4).

initial rates under price caps.[12/] Indeed, the only OPEB expenses reflected in either their current rates or in their starting rates under price caps are the pay-as-you-go amounts embedded in rates at the time the price cap indices were initialized at 100. The 1993 incremental interstate revenue requirement associated with this accounting change is $2,863,000 for Rochester Telephone and $388,000 for Vista. The supporting calculations are set forth in Exhibit III.[13/]

Rochester Telephone and Vista will not seek to recover their entire incremental interstate revenue requirement through exogenous cost adjustments to the price cap indices. First, the total incremental interstate revenue requirement includes items that are not access related, such as billing and collection. Second, a small portion of this incremental

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12/ Id., ¶ 13 (information requests 4, 5 and 6).

Prior to the sale of Centel's Minnesota and Iowa operations to Rochester in 1991, Centel had begun accruing for postretirement benefits. When the sale took place, a liability for postretirement benefits in the amount of $1,766,599.66 was recorded on Vista's balance sheet. There has been no activity to date in this account. This will reduce the TBO to be amortized beginning in 1993 and is reflected in the incremental expense forecast set forth herein.

13/ Exhibit III also shows incremental SFAS 106 expense for 1994, 1995 and 1996. Rochester is providing this information in response to the Designation Order. However, these figures are irrelevant to this filing because Rochester is requesting a one-time exogenous adjustment to its indices to reflect the implementation of SFAS 106.

revenue requirement will be recovered through changes in the GNP-PI. The annualized amounts that Rochester Telephone and Vista will seek to recover through exogenous cost adjustments are $2,352,200 and $344,700, respectively. The derivations of those amounts are set forth in Exhibit IV.

Argument

I. THE IMPLEMENTATION OF SFAS 106 WILL RESULT IN AN EXOGENOUS COST CHANGE UNDER THE COMMISSION'S PRICE CAP RULES.

The primary issue that the Commission has designated for investigation in this proceeding is whether the implementation of SFAS 106 will result in a cost change that is eligible for exogenous treatment under the Commission's price cap rules.[14] As Rochester demonstrates herein, the answer to this question is affirmative. The implementation of SFAS 106 is mandatory and, thus, beyond the control of exchange carriers to recognize for financial reporting purposes. SFAS 106 explicitly recognizes that the pay-as-you-go method of recording OPEB expenses substantially understates the liability actually being incurred. That is, the accounting costs being reported by firms providing OPEBs are substantially less than the true economic costs being incurred by these firms. In the context of a rate regulated industry, the distinction between economic and accounting costs is significant. Rate regulation

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[14] Designation Order, ¶ 10 (Issue I).

has traditionally limited rates to the recovery of accounting costs. Thus, unlike firms which operate in unregulated markets and whose prices necessarily reflect the economic costs of providing their goods and services, regulated firms have been precluded from establishing rates which would recover the true economic costs of providing OPEBs. In these circumstances, implementation of SFAS 106 should presumptively be accorded exogenous cost treatment.

Second, the Commission has correctly concluded that, if GNP-PI will reflect a portion of this expense increase, exogenous cost treatment of that portion would amount to inappropriate double-counting. The NERA Study, however, convincingly explains why SFAS 106 will affect prices in only a very small segment of the national economy and, thus, will increase GNP-PI by, at most, 0.12%. A GNP-PI increase of this magnitude would permit Rochester Telephone and Vista to recover only 4.2% and 6.4%, respectively, of their incremental OPEB expenses associated with interstate access services. As such, the remainder of these incremental expense should be given exogenous cost treatment.

Third, with the exception of this minimal effect on GNP-PI, there are no other factors that would justify any offset to this exogenous cost change. In particular, the Commission asks the parties to comment upon and quantify potential wage changes, their effect on GNP-PI, and what adjustments, if any, should be made to an exogenous adjustment to recognize SFAS 106. No such offset would be appropriate. There is no basis to support the inference that SFAS 106 will lead to any wage changes in the national economy. SFAS 106 represents neither a change in the compensation paid to employees nor a change in the economic costs of providing goods and services. In short, there exists no economic justification for firms to react to the implementation of SFAS 106 with wage changes.

Even if there were an effect on national wage levels, which Rochester does not believe will occur, there is no assurance that exchange carriers would experience such a change in their labor rates. In addition, the price cap formula is intended to account for changes in overall cost levels on a composite basis, not through a discrete assessment of the various components of GNP-PI. Finally, changes in labor expense are within the control of exchange carriers and thus should not be recognized as exogenous events.

A. The Commission Should Presumptively Treat the Incremental Expenses Associated with Implementation of SFAS 106 as Exogenous.

The Commission has required all subject exchange carriers to implement SFAS 106 no later than January 1, 1993.[15/] Exchange carriers, including Rochester, thus have no choice but

15/ *See supra* at 3 n.5.

to adopt the accounting treatment for OPEBs contained in that standard. As a result, the level of expenses that Rochester must record on its books will increase in 1993 over the level that it would have recorded had it continued to report OPEB expenses on a pay-as-you-go basis. That consequence is beyond Rochester's ability to control and, absent any double-counting in GNP-PI, squarely fits within the Commission's definition of a cost that qualifies for exogenous treatment.[16/]

The implementation of SFAS 106 will not affect the economic costs of providing service but, rather, only the timing of when those economic costs are recognized as accounting costs. This fact should, in no way, detract from the qualification of the accounting change for exogenous cost treatment. It is precisely _because_ regulation constrains rates to the recovery of accounting, or book, costs, that the Commission must permit those rates to be adjusted coincident with the change it is mandating in its method of the accounting recognition of those costs.

Unlike firms whose rates are not regulated and thus have been able to reflect the true economic cost of OPEBs in the

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16/ _See_ _Policy and Rules Concerning Rates for Dominant Carriers_, CC Dkt. 87-313, Second Report and Order, 5 F.C.C. Rcd. 6786, 6807, ¶ 166 (1990) ("Second Report and Order").

prices of their goods and services, rate regulated firms have not. This is true for both price cap and cost of service regulated exchange carriers. Although carriers subject to price caps no longer change rates in direct response to cost changes (as rate of return regulated exchange carriers continue to do), the initial price cap rates were established when exchange carriers were required to record OPEB expenses on a pay-as-you-go basis. Had SFAS 106 been in effect just prior to implementation of price caps, the initial price cap rates would have reflected the higher book costs associated with accrual accounting for OPEBs.

Because the Commission is now requiring price cap regulated exchange carriers to adopt SFAS 106, exogenous cost treatment is warranted. This is true not only to avoid imposing upon exchange carriers a burden which they did not create and could not avoid, but it is also required to permit their rates to reflect the economic, rather than the accounting, costs of providing service.

The NERA Study, submitted by Pacific Bell, concluded that:

> In summary, competitive forces drive prices toward economic costs, but regulatory ratemaking sets prices using adopted accounting costs. In unregulated markets, prices already reflect accrual accounting costs for OPEBs because those are the actual economic costs. However, prices in regulated markets have been (and are currently) set to recover cash accounting costs for OPEBs, not accrual accounting costs. Prices of rate-of-return and price-cap regulated

> firms thus entail an intertemporal misallocation of costs in which future ratepayers pay a portion of the economic costs of current services. To correct this inequity, the accounting costs of the regulated firm -- and its prices -- must be adjusted to recover each year's economic costs as they are incurred and to amortize as quickly as possible the accumulated liability for past years' OPEBs. For price-cap regulated firms, a Z adjustment must be made to the price cap.[17/]

Indeed, the Commission has previously recognized that other changes to accounting conventions that do not directly affect the economic costs of providing service qualify for exogenous cost treatment. The Commission's price cap rules require that the expiration of reserve deficiency amortizations be given exogenous cost treatment.[18/] Like the implementation of SFAS 106, changes in book depreciation expense have no effect on the economic value of the assets in question and hence on the economic costs of providing service. The only difference between the expiration of a reserve deficiency amortization and the implementation of SFAS 106 in terms of their respective qualifications for exogenous cost treatment is the direction of the change. The expiration of a reserve deficiency amortization produces a negative exogenous change, while the implementation of SFAS 106 will produce a positive

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17/ NERA Study at 17-18.

18/ *See* 47 C.F.R. § 61.45(d)(1)(i).

change. That, however, is not a relevant consideration. To the extent that the expiration of a reserve deficiency amortization qualifies for exogenous cost treatment, so does the mandatory implementation of SFAS 106.

B. The Effects of SFAS 106 Will Be Reflected Only Minimally in GNP-PI.

The Commission has correctly observed that, to the extent that changes in accounting rules affect GNP-PI, according full exogenous treatment to costs resulting from those changes would result in their over-recovery. This would occur as the price cap indices were adjusted once to account for the exogenous costs and a second time through the effect that these costs had on GNP-PI. Therefore, the issues relevant to determining how much of an exchange carrier's incremental OPEB costs qualify for exogenous treatment are:

> How will the implementation of SFAS 106 affect GNP-PI?
>
> What portion of an exchange carrier's incremental OPEB costs will be recovered through this effect on GNP-PI?

The portion of these incremental expenses that are not recovered through GNP-PI should be afforded full exogenous cost treatment under the price cap rules.[19]

The NERA Study, however, convincingly demonstrates why this accounting change will have absolutely no effect on the prices of firms operating in unregulated sectors of the economy.[20] The NERA Study starts from the fundamental, and to Rochester's knowledge, uncontested premise that, in competitive markets, prices reflect economic, not accounting, costs. The true economic costs of producing a good or service today includes those obligations incurred in the current period to provide postretirement benefits to a firm's employees.[21]

19/ It is important to note that, even if all business entities which are affected by SFAS 106 fully translated their incremental OPEB expenses into higher prices (i.e., the impact of SFAS 106 was fully reflected in an increase in GNP-PI), this would not imply that a price cap exchange carrier would be kept whole through the price cap indexing formula. The implementation of SFAS 106 can be expected to have a disproportionate effect on the exchange carrier industry relative to the economy as a whole. This is true for several reasons, the most obvious of which is that exchange carriers offer OPEBs, while many other firms in the economy do not. Godwins conducted extensive research and determined that the effect of implementing SFAS 106 on the average employer in the economy was only 28.3% of the corresponding effect on exchange carriers. Godwins Study at 1.

20/ The NERA Study provides a proper basis for the Commission to determine what percentage of the expense increase that Rochester will experience under SFAS 106 qualifies for exogenous cost treatment. Although the NERA Study was commissioned by Pacific Bell, its results have general applicability and may validly be used as a basis for ratemaking treatment of Rochester's incremental SFAS 106 expenses. The NERA Study did not, and did not need to, rely upon information unique to Pacific Bell's operations in order to calculate the effect of the implementation of SFAS 106 on GNP-PI.

21/ NERA Study at 17-18.

Thus, in those segments of the economy that are not price regulated and to which SFAS 106 applies, the true economic costs of providing OPEBs have always been reflected in prices. In other words, unregulated firms have always set prices that at least implicitly have reflected accrual accounting principles. Thus, the adoption of SFAS 106 by unregulated companies will have no effect on GNP-PI.

Indeed, the only effect that implementation of SFAS 106 may have on GNP-PI would occur if rate regulated firms and firms that operate under cost-plus contracts with the government are permitted to increase their prices to reflect this accounting change. However, because unregulated firms generate close to 90% of national economic activity, the implementation of SFAS 106 will have only a minor effect on GNP-PI.[22/] Based upon the relative sizes of these sectors of the economy, NERA estimates that the implementation of SFAS 106 will increase GNP-PI by approximately 0.12%.[23/]

As shown in Exhibit IV, Rochester Telephone would recover only approximately 4.2% of its incremental OPEB expenses allocable to interstate access services through a change in GNP-PI. This calculation is straightforward. Rochester Telephone's 1993 annualized interstate access revenue

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22/ NERA Study at 29.

23/ Id. at 31-32.

The specific data, estimates, calculations and sensitivity analyses utilized by NERA (*see* Designation Order, ¶ 16) are set forth in the NERA Study.

requirement is $85,649,000 and its incremental OPEB expense allocable to interstate access is $2,455,000. Thus, to recover this expense, Rochester Telephone must increase its prices for interstate access services by 2.87% overall. However, since 0.12% of this required increase will be reflected in GNP-PI, Rochester Telephone requires only a 2.75% increase in its prices as an exogenous cost adjustment. This amounts to $2,352,000 or 95.8% of its incremental OPEB expense allocable to interstate access services. The similar calculation for Vista is shown on page 2 of Exhibit IV.

As described above, Rochester's interstate access prices were never established to recover anything other than the book accounting costs of OPEBs. Its initial rates under price caps and its current rates do not reflect the incremental expense of implementing SFAS 106.[24/] Permitting rates to be adjusted for the conversion to accrual accounting for OPEBs, and to recover the shortfall in the historic recognition of these costs, will simply enable price cap regulated exchange carriers to recover their OPEB expenses in the same manner as have firms in the economy generally.

C. Additional Offsets to the Level of Incremental OPEB Expense Are Unnecessary and Inappropriate.

In the Designation Order, the Bureau posits that certain

24/ See supra at 9-10.

cost changes, in addition to those discussed in Part B above, may be reflected in one or more components of the price cap formula, and therefore, should be used as offsets to the level of incremental OPEB expense that would otherwise be recognized. The Bureau suggests four such possibilities: (1) the recognition of incremental OPEB expense in current rates; (2) the implicit recognition of such cost changes in the sharing and low end adjustment formulas; (3) the reflection of changes in medical costs in GNP-PI; and (4) potential wage changes resulting from the implementation of SFAS 106.[25/] None provides a basis for the types of offsets suggested in the Designation Order.

As Rochester demonstrated above,[26/] both its current rates and its initial price cap rates reflect none of the incremental expense increase that Rochester will experience by implementing SFAS 106.[27/] As such, any offset on this theory would be totally inapplicable in Rochester's case.

25/ Designation Order, ¶ 11 (information request 5); ¶ 13 (information requests 3-5); ¶ 15.

26/ *See supra* at 9-10.

27/ Moreover, because Rochester has neither created nor funded any Voluntary Employee Benefit Association Trust or similar mechanism (*see* Designation Order, ¶ 11 (information request 3)), neither Rochester's current rates nor its initial price cap rates reflect or reflected such costs.